(11)

No. 95-809

In The

Supreme Court of the United States

October Term, 1995

LOCKHEED CORPORATION, *et al.*,

Petitioners,

v.

PAUL L. SPINK,

Respondent.

On Writ Of Certiorari
To The United States Court Of Appeals
For The Ninth Circuit

BRIEF *AMICUS CURIAE* OF THE CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA IN SUPPORT OF THE PETITIONER

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QUESTIONS PRESENTED

1. Are a pension plan sponsor and plan fiduciaries liable for breach of fiduciary duty under the Employee Retirement Income Security Act of 1974 ("ERISA"), when the plan sponsor amends the terms of its pension plan to create new benefits for a voluntary early retirement program made subject to specified eligibility criteria and plan benefits are then paid to eligible participants pursuant to the terms of the amended plan?

2. Does the Omnibus Budget Reconciliation Act of 1986 ("OBRA '86"), which amended ERISA and the Age Discrimination in Employment Act ("ADEA"), apply retroactively to require pension benefit accruals for years an employee lawfully was excluded from plan participation, where the legislation does not expressly require retroactive application and where there is no clear intent by Congress to impose retroactive liability for pension benefits?

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INTEREST OF THE *AMICUS CURIAE*

The Chamber of Commerce of the United States of America ("the Chamber") is the largest federation of business companies and associations in the world. With substantial membership in each of the 50 states, the Chamber represents over 215,000 businesses and professional organizations, as well as several thousand state and local chambers of commerce, and serves as the principal voice of the American business community. An important function of the Chamber is to represent the interests of its members in important matters before this Court, the lower courts, the United States Congress, the Executive Branch and independent regulatory agencies of the federal government.

Accordingly, the Chamber has sought to advance those interests by filing briefs in cases of importance to the business community addressed by this Court. For example, the Chamber has participated *amicus curiae* in the following ERISA cases pending or recently decided in this Court: *Varity Corp. v. Howe*, 115 S. Ct. 179 (1995), *Curtiss-Wright Corp. v. Schoonejongen*, 115 S. Ct. 1223 (1995), *District of Columbia v. The Greater Washington Board of Trade*, 113 S. Ct. 580 (1992), *Patterson v. Shumate*, 113 S. Ct. 13 (1992), *Ingersoll-Rand v. McClendon*, 498 U.S. 133 (1990), *FMC Corp. v. Holliday*, 498 U.S. 52 (1990), and *Laborers Health & Welfare Trust Fund v. Advanced Lightweight Concrete*, 484 U.S. 539 (1988).

The Chamber's members have a vital interest in the proper interpretation and application of ERISA because they collectively sponsor hundreds of thousands of employee benefit plans covered by ERISA, both pension and welfare. In particular, they have a substantial interest in ensuring that the statute is interpreted and applied in a uniform and consistent manner across the nation, because many of these plans cover participants and beneficiaries in multiple states.

The misguided decision below, which subjects plan sponsors to fiduciary responsibility when amending their plans (including the prohibited transaction rules), casts doubt on the validity of most amendments to funded employee benefit plans covered by ERISA, such as pension plans, both retroactively and prospectively, thus casting employers and plan administrators into doubt about the terms of their plans and inevitably enmeshing the federal courts in reviewing the merits of each plan amendment. In addition, for those employers who lawfully excluded from their pension plans employees who were hired within five years of normal retirement age, the decision below imposes retroactive liability that vastly multiplies the funding burden, compared to the prospective liability that Congress clearly intended to impose, thus endangering the maintenance and improvement of pension plans contrary to the intent of Congress.

Petitioner and respondent have both consented to the Chamber's filing of a brief *amicus curiae* in this matter. A copy of their joint consent letter, the original of which has previously been filed with the Court, is filed simultaneously herewith.

SUMMARY OF ARGUMENT

I. The decision below rests on the erroneous proposition that section 406(a) of ERISA prohibits an employer from receiving a valuable benefit from its employees in return for providing benefits under a funded employee benefit plan. Embedded in that proposition is the equally erroneous corollary that an employer acts in a fiduciary capacity when setting the terms and conditions of an employee benefit plan.

Common sense dictates that the decision below be approached with skepticism because, if those propositions were true, employee benefit plans simply could not function. In a free market economy, an employer always provides employee benefits in return for valuable benefits from the employee, starting with simple labor but often involving direct monetary benefit as well. And the settlor function (where the settlor is expected to act in its own best interest) is inherently incompatible with fiduciary rules (where the fiduciary must act solely in the interest of the participants in the plan).

The language, structure and policy of ERISA all clearly reflect the demarcation between the traditional settlor function and the traditional fiduciary functions. The statutory definition of fiduciary, which consists of a description of functions, includes no settlor functions. While fiduciary functions are regulated by the fiduciary responsibility rules of Part 4 of Title I of ERISA, Congress chose instead to regulate the settlor function with substantive minimum standards, which appear in Part 2 of Title I. Finally, the policy of ERISA is not to regulate the contents of the promise (the settlor function), only to assure that whatever promise the employer makes is kept (the fiduciary function).

The natural temptation to decide that the performance of the settlor function usually is *not* subject to fiduciary responsibility but sometimes *is* (as the court of appeals did) cannot be gratified without invoking a judgment of degree that destroys the "bright line" test for prohibited transactions that Congress carefully constructed in section 406 of ERISA. If the existence of a prohibited transaction (and therefore the validity of an amendment) rested on a judgment of degree, such as whether the benefit to the employer from the amendment is more than "incidental," then employers would be uncertain about the validity of most amendments previously made to pension plans, as well as the validity of future plan amendments. Plan administrators would be placed in the untenable position of not knowing for sure the terms of the plans they administer, with the threat of

personal liability for implementing an amendment later determined to have been a prohibited transaction.

Perhaps worst of all, however, if the validity of plan amendments depended on a judgment of degree, the federal courts would be enmeshed in deciding the validity of countless individual plan amendments. In many cases, employees would challenge unfavorable amendments. In many others, the plan administrator would seek declaratory judgment to settle the terms of the plan. Since these actions would involve fiduciary responsibility under ERISA, the jurisdiction of the federal courts would be exclusive. In this regard, the decision below carries much the same effects as the court of appeals decision in *Curtiss-Wright Corp. v. Schoonejongen*, 115 S. Ct. 1223 (1995), and makes an equally compelling case for reversal.

II. As to the second question presented, the decision below applies the Omnibus Budget Reconciliation Act of 1986 ("OBRA '86") retroactively, in disregard of the express intent of Congress that application be prospective only. ERISA, as originally enacted, permitted plans to exclude from participation employees who were hired less than five years before normal retirement age (for reasons of cost), and Mr. Spink was lawfully excluded from the Lockheed pension plan when hired in 1979 at age 61.

In OBRA '86 Congress reversed itself and required plans to admit older employees, despite the cost, but "only with respect to plan years beginning on or after January 1, 1988, and only with respect to service performed on or after such date." Accordingly, the Lockheed pension plan permitted Mr. Spink to participate from and after the effective date of OBRA '86 in 1988. By requiring that Mr. Spink be given credit for the period from 1979 to 1988 – when he was lawfully excluded from the plan – the decision below gives retroactive effect to OBRA '86 contrary to the express intent of Congress.

Retroactive application of OBRA '86 does not impose just a marginal increase in cost on pension plans, however. Retroactive application produces a "multiplier" effect. If an older employee participates in a plan *prospectively* after OBRA '86, he may accrue a benefit based on just a few years of service and therefore impose a modest new liability on the plan. If he must be given *retroactive* credit for service from his date of hire (before OBRA '86), the effect can easily triple or quadruple his pension and therefore triple or quadruple the funding burden on the plan. When the effect is multiplied across the universe of pension plans and the number of affected employees, the *additional* liability flowing from retroactive application might reach $1.7 billion – a liability never intended by Congress that may, ironically, lead to the reduction or elimination of pension plans.

ARGUMENT

I. SECTION 406(a) OF ERISA DOES NOT PROHIBIT AN EMPLOYER FROM RECEIVING A VALUABLE BENEFIT FROM ITS EMPLOYEES IN RETURN FOR PROVIDING BENEFITS UNDER A FUNDED EMPLOYEE BENEFIT PLAN.

Lifted from the specific factual context, the decision below rests on the proposition that it is a prohibited transaction under section 406(a) of ERISA for an employer to receive a valuable benefit from its employees as a condition to eligibility for benefits under a funded employee benefit plan. Lurking within that proposition is the corollary that an employer acts as a fiduciary in setting conditions for eligibility under employee benefit plans. As *amicus curiae*, the Chamber would like to assist the Court by making clear, not just that the propositions are untrue, but that employee benefit plans could not function if they were true.

Preliminarily, however, we must dispose of a question that some readers feel is left unclear in the decision below – whether the prohibited transaction supposedly resides in the act of including the release in the plan amendment or in the act of administering the plan in accordance with those terms. We believe the essence of the decision below, and the proper battleground in this Court, is the amendment itself, partly because that is what the decision says but more importantly because it cannot be a prohibited transaction to pay benefits to participants in accordance with the terms of the plan.

A. Paying Benefits to Participants in Accordance with the Terms of the Plan Is Not a Prohibited Transaction under Section 406(a) of ERISA.

A prohibited transaction under section 406(a) of ERISA occurs when a fiduciary causes a plan to engage in a transaction described therein with a "party in interest," unless the transaction is exempt under section 408. One such prohibited transaction – the one at issue in this case – is the "transfer to, or use by or for the benefit of a party in interest, of any assets of the plan." Section 406(a)(1)(D), 29 U.S.C. § 1106(a)(1)(D).

Parties in interest are defined in section 3(14) of ERISA, 29 U.S.C. § 1002(14), and specifically include both the employer whose employees are covered by the plan *and the employees themselves*. Since paying benefits to participants in accordance with the terms of the plan obviously constitutes a "transfer" of "assets of the plan" to a "party in interest," as well as a use of plan assets "by or for the benefit of a party in interest," payment of benefits to participants would itself be prohibited under section 406(a) but for the exemptions in section 408.

Section 408(b)(9), 29 U.S.C. § 1108(d)(9), provides the appropriate exemption: "[t]he making by a fiduciary of a distribution of the assets of the plan in accordance with

the terms of the plan . . . " While most often invoked with regard to distributions upon termination of a plan, section 408(b)(9) on its face is not limited to plan termination. It merely provides that, if the distribution is by reason of plan termination, the distribution must also satisfy the detailed rules regarding distributions upon plan termination.[1] Thus, paying benefits to participants in accordance with the terms of the plan is not a prohibited transaction under section 406(a) of ERISA.

In the present case, therefore, if there is a prohibited transaction under section 406(a) of ERISA, it must inhere in the act of conditioning eligibility for the special "window" pension on execution of a release. That is exactly what the decision below says: "The only remaining question, then, is whether *the 1990 Plan amendments* were a transaction that directly or indirectly benefitted Lockheed . . . For these reasons, we conclude that the [*sic*] Lockheed's *adoption of the 1990 Plan amendments* violated ERISA because the amendments provided for use of Plan assets to purchase a significant benefit for Lockheed." Jt.

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[1] As described in the Conference Report to ERISA:

> It is not a prohibited transaction for a plan to distribute its assets in accordance with the provisions of the plan and in the case of a pension plan if the distribution is in accord with the allocation of assets rules under the termination insurance provisions of the substitute.
>
> Also, a distribution of assets from a welfare (or pension) plan, as described above in "Basic fiduciary rules" is exempt from the labor provisions as to prohibited transactions.

H.R. Rep. No. 93-1280, 93d Cong., 2d Sess. 316 (1974). To read section 408(b)(9) as limited to plan terminations would lead to the absurd conclusion that, prior to termination, all distributions to participants in accordance with the terms of the plan are prohibited transactions.

App. at 89, 91 (emphasis added).[2] Accordingly, that is the issue that we address here.

B. Employee Benefit Plans Could Not Function If an Employer Were Prohibited from Receiving a Valuable Benefit from Its Employees as a Condition to Eligibility for Benefits under an Employee Benefit Plan.

The "gratuity" theory of employee benefits was discredited long before ERISA was enacted.[3] Nowadays, there can be no doubt that employee benefits are part of the mutual exchange of value between an employer and employee. An employer offers compensation, which may be immediate cash (such as paycheck), immediate benefits (such a medical insurance), or deferred cash or benefits (such as a pension). In return, the employer receives valuable benefits from the employee:

– The benefit may be coming to work for the employer. Suppose, for example, that an employer has a pension plan with early retirement at age 60. Its competitors have pension plans with early retirement at age 55. In order to attract employees, the employer may have to amend its pension plan to provide early retirement at age 55. If so, there is no doubt that the employer enjoys a real and substantial economic benefit from amending the pension plan.

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[2] Consistent with the quoted statements from the opinion, the decision below does not confront or overcome – indeed, it never mentions – ERISA section 408(b)(9), as it would have had to do if it had held that the prohibited transaction lay in carrying out the amendment, rather than making the amendment.

[3] *Inland Steel Co. v. NLRB*, 170 F.2d 247 (7th Cir. 1948), *cert. den.*, 336 U.S. 960 (1949). *See, generally, Employee Benefits Law* 249-250 (Bureau of National Affairs 1991).

– The benefit may be reducing turnover among the workforce. While younger employees may choose to work at a company with a pension plan providing modest pensions, as the employees grow older, they may desert the company for a competitor that offers a superior pension plan. The first employer may have to improve the benefits under its pension plan, and if it does so, there is no doubt that it enjoys a real and substantial economic benefit from retaining its workforce through their most productive years.

– The benefit may be fostering turnover. In the modern era where mandatory retirement on account of age is unlawful, an employer with a poor pension plan may find that its older employees choose not to retire. Without jobs being opened up for new, young employees, normal turnover is disrupted, with the result that necessary skills are not passed down to the next generation and the cost of labor increases every year as the average age of the workforce increases. The employer may very well amend its pension plan to improve retirement benefits in order to promote the orderly turnover in its workforce that is essential to long-term economic success.

– The benefit may be financial. In difficult times, the employer may not be able to afford increases in current cash compensation but may wish to reward its employees for their hard work and loyalty. Amending the pension plan to increase the benefits may provide the perfect solution: granting a valuable benefit without a corresponding current cash requirement. Indeed, if the pension plan is overfunded, there may be no current cash cost to the employer at all. In this scenario, there is no doubt that the employer enjoys a real and substantial economic benefit from amending the pension plan.

These examples lay bare a fundamental truth that the decision below overlooks: employers are not eleemosynary institutions; they provide employee benefits in order to receive a valuable benefit in return. This is neither

surprising nor disturbing in a free market economy. It means, however, that employee benefit plans could not function if an employer were prohibited from conditioning eligibility for benefits under an employee benefit plan on the employee's conferring a valuable benefit on the employer.

With that understanding, we can ratchet up the examples by introducing the concept of direct monetary benefit to the employer:

– Suppose that an employer has an overfunded pension plan. Suppose that labor costs are too high because the number of employees is too great. Suppose the employer amends the pension plan to provide dramatically improved pensions to employees who retire during a "window" period of 60 days, with no release of any kind required from the employees. Suppose that most of those eligible for retirement take early retirement under the window and enjoy the improved pensions, resulting in a direct, monetary savings to the employer in salaries. Even without a release, there can be no doubt that the expenditure of plan assets is conditioned on the employees' conferring a monetary benefit on the employer by their retirement.

– Suppose that, at the expiration of a collective bargaining agreement, the union calls a strike. Suppose that the union charges the employer with unfair labor practices during the strike. But suppose that the employer and union settle the strike, including the union's charges of unfair labor practices, by entering into a new collective bargaining agreement that calls for increases in pension benefits. And suppose that the pension plan is overfunded, so that the pension increases carry no current cost for the employer. There can be no doubt that the expenditure of plan assets is conditioned on the employees' conferring a monetary benefit on the employer by relinquishing their claims of unfair labor practices.

– For the starkest example of direct monetary benefit to the employer, suppose that an employer must reduce wage costs and therefore announces reductions in wages (or proposes wage concessions to the union, if the employees are represented). To soften the blow, the employer agrees to improve pensions. Suppose the pension plan is overfunded, so that the improvement in pensions carries no current cost to the employer. When this arrangement is finalized (through a new collective bargaining agreement, if the employees are represented), there can be no doubt that the expenditure of plan assets is conditioned on the employees' conferring a monetary benefit on the employer by reducing their wages.

We doubt that anyone would quarrel with the propriety of the employer's behavior in any of the foregoing examples, including the last three, all of which are common occurrences. But in all of those examples the amendment of the pension plan would constitute a prohibited transaction if the decision below were correct that it is prohibited for the employer to receive a valuable benefit from its employees as a condition to eligibility for benefits under an employee benefit plan. The fact that employee benefit plans simply *could not function* under the proposition adopted below strongly suggests that it is not the law.

C. By Leaving Settlor Functions Unaffected by Fiduciary Rules, ERISA Leaves Employers Free to Seek Their Own Self-interest When Determining What the Terms of Their Plans Shall Be, Including Changing or Ending Them.

It would be most remarkable if ERISA, a law designed to promote and protect employee benefits, enshrined a principle under which employee benefit plans simply could not function. Of course, it did not, because in both its language and its structure ERISA

reflects the distinction between settlor functions and fiduciary functions.

The prohibited transaction rules of section 406 of ERISA are a subspecies of the fiduciary rules of ERISA, which occupy Part 4 of Title I of ERISA (sections 401-414, 29 U.S.C. § 1101-1114). That prohibited transactions are limited to the world of fiduciary responsibility is reflected on the face of section 406 itself, which begins with the phrase, "A *fiduciary* with respect to a plan shall not *cause the plan to engage in a transaction*, if he knows or should know that such transaction constitutes a direct or indirect . . . " ERISA section 406, 29 U.S.C. § 1106 (emphasis added). Absent fiduciary activity, the prohibited transaction rules of section 406 simply do not apply.[4]

Fiduciary activity is defined in ERISA section 3(21), 29 U.S.C. § 1002(21), by reference to functions. What is striking about that definition is that all of the functions described there relate to the administration of the plan and its assets *once its terms have been established by the settlor*. None of the functions that give rise to fiduciary responsibility relate to setting the eligibility conditions under the plan, changing the eligibility conditions, or deciding to end the plan – the traditional settlor function.

The ERISA definition of fiduciary therefore implicitly reflects the traditional distinction in common law between settlor functions and fiduciary functions. Under

[4] In addition, in this case, there is no "transaction," because the employer gives nothing to the plan and receives nothing from the plan. That fact distinguishes this case from *Commissioner v. Keystone Consolidated Industries, Inc.*, 113 S. Ct. 2006 (1993), in which the transaction consisted of the employer's contributing property to a plan in satisfaction of the funding requirement of law and this Court concluded that the transaction was a prohibited "sale or exchange" between the plan and a disqualified person under section 4975 of the Internal Revenue Code of 1986.

the common law of trusts, in establishing the terms of the trust, the settlor acts free from any fiduciary responsibility: "The settlor in creating a trust can make such provisions with respect to . . . the rights of the beneficiaries as he may deem wise; if the provisions do not run counter to any rule or policy of the law they are valid and enforceable." I W. Fratcher, *Scott on Trusts* §§ 3-4 at 51-53 (4th ed. 1989). Further, a settlor who reserves the right to amend the trust has unfettered discretion to do so, including "changing the beneficiaries, or cutting down or increasing the extent of the interests of the beneficiaries," free from any fiduciary responsibility. *Id.*, § 331 at 378-381. Similarly, the settlor may revoke a trust, free from fiduciary responsibility. *Id.*, § 330 at 344-345.

The analog in employee benefits to the settlor function in the common law of trusts is setting up the conditions of eligibility for benefits under an employee benefit plan and establishing the amount of benefits. That includes not only the original design of the plan but also decisions about amending the plan and the decision to terminate the plan altogether, termination being the ultimate restriction of eligibility for benefits. As a result, the act of amending a plan to set (or change) the conditions of eligibility for benefits is a settlor function, not a fiduciary function, and is therefore off limits from the prohibited transaction rules and all other fiduciary rules.[5]

[5] It is unnecessary in this case to make the more sweeping assertion that *all* amendments represent an exercise of the settlor function. In this case, Lockheed's amendment did no more than set up the conditions of eligibility for an additional new benefit under the plan (the enhanced "window" early retirement benefit). We leave for another day the question of whether an amendment that went beyond the traditional settlor function and purported to invade the traditional trustee function would likewise be exempt from the fiduciary rules.

The distinction between settlor and fiduciary functions is critical, not just to the prohibited transaction rules, but to all of the fiduciary responsibility rules. For example, another rule of fiduciary responsibility obligates a fiduciary to eschew any self-interest and, instead, to act exclusively in the interest of the participants in the plan – generally referred to as the "exclusive benefit" rule. ERISA section 404(a)(1)(A), 29 U.S.C. § 1104(a)(1)(A). Needless to say, the settlor function could not be performed if it were subject to the exclusive benefit rule, because an employer almost always acts in its own self-interest (and properly so) in determining who is eligible for benefits, under what conditions, and how much they receive. Yet the decision below necessarily includes the corollary that Lockheed was acting as a fiduciary in adopting the amendment in question and so – even apart from the prohibited transaction rules – it would declare open season under the exclusive benefit rule on virtually all amendments to funded employee benefit plans.[6]

Though the settlor function is not susceptible of regulation by the fiduciary rules, however, Congress did not lack the ability to regulate the settlor function; it merely had to choose a different structure. Harking back to the common law rule that even a settlor cannot set up terms that "run counter to any rule or policy of the law" (*Scott on Trusts*, *supra*, at 53), Congress regulated the settlor function by establishing substantive minimum standards

[6] The analysis of the court of appeals applies to all employee benefit plans covered by ERISA that have assets, that is, almost all pension plans and some welfare plans. According to the U. S. Department of Labor, there were 730,106 pension plans alone covered by ERISA in 1988. *Trends in Pensions 1992*, U. S. Department of Labor, Pension and Welfare Benefits Administration 602.

for employee benefit plans, which appear in Part 2 of Title I (and, with regard to plan termination, in Title IV).

For example, section 202, 29 U.S.C. § 1052, generally does not permit an employer to set up a minimum age requirement for participation in a pension plan that is higher than age 21 or a minimum period of service with the employer of more than one year. Section 203, 29 U.S.C. § 1053, generally does not permit an employer to impose a requirement that an employee work for the employer for more than five years before becoming vested in his or her pension. Section 204, 29 U.S.C. § 1054, generally does not permit an employer to amend a pension plan where the effect would be to reduce the accrued benefit of a participant. All the rest of Part 2 of Title I follows the same pattern.

From the language and structure of ERISA, therefore, two conclusions emerge. The discretion of the settlor in setting up the terms of a plan is regulated by substantive minimum standards that are distinct from the rules of fiduciary responsibility. But within the boundaries established by the minimum standards, ERISA does not fetter the settlor's discretion in deciding who shall be entitled to benefits and under what conditions.

This line of demarcation between settlor and fiduciary functions is completely consonant with the over-all purpose of ERISA, not to define the employer's promise, but instead to assure that the employer keeps whatever promise it makes. Within the boundaries of the substantive minimum standards, ERISA does not seek to dictate the employer's promise; it seeks only to assure that the promise is definite (in a written plan document), is disclosed to participants (through the plan document and summary plan description), is funded or insured by assets outside the reach of the employer (through the trust and funding rules), and in the event of termination is fulfilled by plan assets, by additional payments from the employer, or, where applicable, by the Pension Benefit

Guaranty Corporation (in the plan termination provisions).[7]

The result in this case is that Lockheed's decision to establish a release as a condition under its pension plan to eligibility for an additional new benefit is a settlor decision not subject to attack under the fiduciary rules (whether the prohibited transaction rules, the exclusive benefit rule, or any other fiduciary rules). It is tested only against the substantive minimum standards of ERISA, which do not (and could not reasonably) prohibit an amendment merely because, in return, the employer receives a substantial benefit – even a monetary benefit – from the employee.

D. Blurring the Line Between Settlor and Fiduciary Functions Inevitably Destroys the Bright Line Test for Prohibited Transactions, Creating Intolerable Uncertainty for Employers and Administrators and Forcing the Federal Courts to Review Plan Amendments One by One for Validity.

It is possible to conjure up hypotheticals that, viewed in isolation, put the demarcation between settlor and

[7] Both the Internal Revenue Service and the Department of Labor have repeatedly recognized that, as long as the plan does not slip below the substantive minimum standards of ERISA, the employer is free to seek its self-interest in establishing the terms of the plan. For example, to the extent that a pension plan vests a participant faster than ERISA requires, it may take away that vested benefit for any reason, such as leaving the employer to engage in competitive employment. 26 C.F.R. § 1.411(a)-4(a) and (c) (Example 1). For another example, ERISA protects payment of the "normal retirement benefit" at "normal retirement age," but any benefit *greater* than the normal retirement benefit or payable *before* normal retirement age can be taken away for any reason that the employer chooses to put in the plan. 29 C.F.R. § 2530.203-3(a).

fiduciary functions to a severe test. One reaction is to decide that the demarcation is not absolute – that the settlor function can sometimes be subject to fiduciary responsibility, such as the prohibited transaction rules. That reaction is a serious mistake under ERISA, given the unusual structure of the prohibited transaction rules.

The prohibited transaction rules of ERISA are unusual in that they are absolute. Under section 406 of ERISA, a transaction is prohibited merely because the transaction is with a "party in interest," such as the employer. "Party in interest" is defined in explicit detail in section 3(14) of ERISA, 29 U.S.C. § 1002(14). *No other considerations apply.* Congress deliberately made the prohibition absolute, without regard to the motives of the fiduciary or the effect on the participants in the plan or any other consideration whatsoever, so as to create a bright line, as this Court noted in *Commissioner v. Keystone Consolidated Industries, Inc.*, 113 S. Ct. 2006 (1993) ("Congress' goal was to bar categorically a transaction that was likely to injure the pension plan.")

Congress understood very well that a flat prohibition, removing any element of judgment, would bar not only abusive transactions but also some innocuous transactions.[8] It decided, however, that the advantage of a bright line outweighed any disadvantage. The advantage, of course, was better enforcement through letting sponsors and administrators of plans know in advance what was impermissible (without exposing themselves to personal liability through trial and error) and removing the need for decades of judgment calls in the federal courts to refine the rules.[9]

[8] *See, e.g.*, H.R. Rep. 93-1280, 93d Cong., 2d Sess. 310 (1974).

[9] *See, e.g.*, S. Rep. No. 93-383, 93d Cong., 2d Sess. 95 (1973).

If the demarcation between settlor and fiduciary functions is blurred, however, the bright line of the prohibited transaction rules cannot be maintained. This is the corner into which the court of appeals painted itself in this case. Implicitly recognizing that the prohibited transaction rules of ERISA *as written* would prohibit virtually all amendments to pension plans (under its theory), the decision below obliterates the absolute prohibition established by Congress and substitutes a judgment of degree: an amendment is prohibited if the benefit to the employer is more than "incidental" but not if the benefit is merely "incidental."

Any approach that does not strictly maintain the demarcation between settlor and fiduciary functions is forced to do the same: ignore the simple on-off toggle switch enacted by Congress in section 406(a) and start drawing lines and weighing factors. But substituting a judgment of degree for a bright line test would immediately cast the employee benefits community into the very pickle that Congress sought to avoid by providing a clear and definite standard not involving judgment. The serious negative effects would be felt by employers, administrators and the federal courts alike.

From the employer's point of view, if plan amendments really were subject to the fiduciary rules of ERISA and a prohibited transaction were a judgment of degree, an employer would hesitate to amend its pension plan, even to raise benefits – a result clearly at odds with the intent of Congress in ERISA to encourage pension plans to provide retirement security for employees. The only safe course for the employer would be to freeze or terminate the existing plan and start a new plan that embodied the desired plan amendment.[10] But it cannot have been

[10] Respondent and his *amici* in the court below agreed that the act of creating a new plan cannot involve a prohibited

the intent of Congress to force upon employers such an unnecessary and wasteful exercise as freezing the existing plan (and then running the frozen plan and the new plan simultaneously), or else terminating the existing plan, just to make an amendment.[11]

The administrator of the plan has a different point of view. As a fiduciary, the plan administrator has a duty not to give effect to plan amendments that constitute prohibited transactions. ERISA section 404(a)(1)(D), 29 U.S.C. § 1104(a)(1)(D). As written, the prohibited transaction rules are capable of relatively easy application by a plan administrator with no judgment of degree, simply by asking, Is the other party to the transaction a "party in interest"? But if prohibited transactions were a question of degree, the plan administrator would be uncertain whether any particular amendment benefits the employer to the degree where it becomes prohibited, and the plan administrator would be ill equipped to make the necessary investigation and judgment.

This would be all the more true where the plan is administered by an independent third party known as a

transaction, even on their theory that amending a plan involves the fiduciary rules of ERISA, because a new plan has no assets until after it is established. Thus, they agreed that a new plan could have the very feature that, if added to an existing plan, would constitute a *per se* prohibited transaction under ERISA. Common sense rebels at this bizarre dichotomy, which finds no basis in ERISA, but if it is the law, employers will be forced to make use of it, as described in the text.

[11] Since ERISA does not require welfare plans to be funded at all, those employers which have chosen to enhance the security of the benefits by funding them would find that they are hamstrung by the decision below, whereas there would be no problem if the plan were unfunded. Ironically, therefore, the decision below, which pays lip service to increasing the security of employees in their benefits, would exert irresistible pressure on employers to abandon funding of their welfare plans.

"third-party administrator." A third-party administrator's expertise is in day-to-day administration of plans; typically, the third-party administrator has little knowledge of the employer's business. It would be fanciful to expect third-party administrators to judge whether plan amendments benefit the employer more than "incidentally" (or according to any other formulation involving judgment) and therefore are void as prohibited transactions.

Moreover, the plan administrator would face personal liability under ERISA for deciding that question wrong. If the plan administrator implemented a plan amendment, for example, and it were later determined that the amendment was void as a prohibited transaction under ERISA, the plan administrator could be personally liable to make the plan whole for all benefits paid under that amendment. ERISA section 409, 29 U.S.C. § 1109. There is no indication in ERISA that Congress intended to put plan administrators in such an untenable position and there is no policy reason for doing so.

From the perspective of the federal judiciary, the news is even worse. In the climate of uncertainty created by the decision below, and faced with enormous personal liability, the only sensible course for plan administrators, as fiduciaries, will be to apply to a federal district court for instructions as to whether particular amendments are lawful or, instead, are prohibited transactions. This Court has expressly recognized the right of a fiduciary under ERISA to apply to a federal court for instructions. *Firestone Tire and Rubber Co. v. Bruch*, 489 U.S. 101, 112 (1989). Even if the administrator does not seek declaratory judgment, any participant in the plan may sue in federal court to overturn the amendment on the ground that it is a prohibited transaction, thus forcing the federal courts into the business of examining amendments individually

to determine whether the benefit to the employer is "incidental" or not.[12]

Needless to say, enmeshing the federal courts in analyzing the degree of benefit to an employer from individual amendments to employee benefit plans represents a cost to the private sector and a burden to the judiciary that cannot possibly have been intended by Congress in ERISA and will only feed the growing attitude of employers that the legal regulation of employee benefit plans has made them too risky and too expensive.

This case presents a picture strikingly similar to what the Court saw last term in *Curtiss-Wright Corp. v. Schoonejongen*, 115 S. Ct. 1223 (1995). In *Curtiss-Wright*, a plaintiff dissatisfied with the employer's legal authority to amend a plan concocted a new theory that the standard language in plans, reserving to employers the authority to amend the plan, is legally insufficient under ERISA, thus casting doubt on the validity of nearly all plan amendments adopted since ERISA and creating an entire new class of ERISA litigation as participants and plan administrators litigate the validity of individual plan amendments.

The shock wave in *Curtiss-Wright* was shaped a little differently from this case. *Curtiss-Wright* applied to both pension and welfare plans but had mainly retroactive

[12] The argument that Lockheed's amendment was a prohibited transaction was made most eloquently in the court of appeals, not by Mr. Spink, but by Mr. Spink's *amicus curiae*, the International Union of Petroleum and Industrial Workers, whose brief was devoted entirely to this issue. No doubt employees everywhere are salivating at the thought that amendments are prohibited if the employer derives any substantial benefit from them, a rule that would permit employees to defeat at will almost any amendment to an employee benefit plan and would spark a renaissance of ERISA litigation that would make the retiree insurance explosion of the past decade look puny by comparison.

effect. (Prospectively, an employer could solve the *Curtiss-Wright* problem by modifying the amendment language in the plan.) This case applies mainly to pension plans but has both retroactive and *unlimited prospective* effect. Here, the source of the problem is not plan language, which the employer can modify, but section 406(a) of ERISA, which will continue to apply to (and call into question) future pension plan amendments, if the decision below stands.

Over-all, the destructive force of the decision below on employers, plans and the federal judiciary is comparable to the court of appeals decision in *Curtiss-Wright*, particularly because of the open-ended prospective effect. In *Curtiss-Wright*, the Chamber urged the Court, in unusually strong terms, to reverse the decision, and it did so. We respectfully urge the same in this case as to the first question presented.

II. BY GIVING RETROACTIVE EFFECT TO OBRA '86, THE DECISION BELOW FLOUTS THE EXPRESS INTENT OF CONGRESS AND WOULD VASTLY MULTIPLY THE FINANCIAL BURDENS BEYOND WHAT CONGRESS INTENDED.

The decision below gives retroactive effect to statutory provisions as to which Congress clearly expressed its intention that application be prospective only, thus bringing the decision below into conflict with this Court's decision in *Landgraf v. USI Film Products*, 114 S. Ct. 1483 (1994). Since Mr. Spink has steadfastly denied the retroactive nature of his claim (and of the decision below), the Chamber would like to underlinc the retroactivity, which is clear when the technical issue is put into a larger historical context. We will then content ourselves with the demonstration in the brief of Lockheed that Congress intended the applicable provision to operate prospectively only. But we will illuminate for the Court the

serious practical consequences of applying it retroactively, since retroactive application brings into play a dangerous "multiplier" effect.

A. The Decision below Gives Retroactive Application to the Requirement of OBRA '86 That Older Employees Be Permitted to Participate in Pension Plans.

The retroactive effect of the decision below is clear when it is understood how benefits accrue under a defined benefit pension plan. With a few exceptions not relevant here, benefits accrue ratably over the period that the employee participates in the plan. For example, a typical pension plan might provide a monthly benefit at retirement of $50 multiplied by the number of years that the employee has participated in the plan. If an employee works 30 years and retires, his monthly pension is $1,500. In this example, the employee's pension has accrued ratably over 30 years, at a rate of $50 per year. This methodology is not only logical and fair; it is the law. ERISA section 204(b)(1), 29 U.S.C. § 1054(b)(1).

Since length of participation in the plan determines the amount of pension, ERISA closely regulates the matter of when employees begin participation in pension plans. ERISA section 202, 29 U.S.C. § 1052. Among the original participation rules, ERISA expressly permitted a plan to exclude from participation employees who were hired less than five years before normal retirement age. (Since normal retirement age is typically 65, this permitted the typical plan to exclude employees hired after age 60.)

ERISA permitted this exclusion of employees hired after age 60 for a very specific reason. Pensions are generally funded over the working life of the employee. For most employees, that means a period of decades, which

permits the plan to accumulate the necessary assets gradually over many years. On the other hand, if an employee could join a plan and retire just one or two years later, it would impose a large, unexpected liability on the plan, which the plan would be unable to finance over a long working life. In view of the cost, Congress permitted plans to exclude such employees altogether.[13]

In accordance with ERISA, the Lockheed plan, like many others, lawfully excluded from participation employees who were hired within 5 years before normal retirement age. As a result, when Mr. Spink was hired in this case in 1979 at age 61, he was lawfully excluded from the pension plan. Since he did not participate, he did not accrue any benefit under the plan.

In 1986, Congress changed ERISA so that pension plans could no longer exclude employees from participation merely because they were hired after a certain age. Omnibus Budget Reconciliation Act of 1986 ("OBRA '86"), section 9203(a), 100 Stat. 1979 (1986). Congress said that the change in the law applied "only with respect to plan years beginning on or after January 1, 1988, and only with respect to service performed on or after such date." OBRA '86, section 9204(b), 100 Stat. 1980 (1986). It is difficult to imagine a clearer specification of prospective effect.

Accordingly, when OBRA '86 took effect with respect to the Lockheed pension plan in 1988, Mr. Spink became entitled to participate in the Lockheed pension plan, but "only with respect to service performed on or after such date." The plan was duly amended to provide that Mr. Spink was permitted to participate on the OBRA '86 effective date, and he did in fact begin to participate in the plan in 1988. Since the amount of benefit depends on

[13] *See, e.g.*, H.R. Rep. No. 93-1280, 93d Cong., 2d Sess. 262 (1974), and H.R. Rep. No. 93-807, 93d Cong., 2d Sess. 46 (1974).

the length of participation in the plan, Mr. Spink's benefit was thereafter calculated by reference to the length of his actual participation in the plan, that is, from and after the effective date of OBRA '86 in 1988.

What Mr. Spink sought, and the court of appeals granted him, was additional credit for the period from his hiring to the effective date of OBRA '86 – from 1979 to 1988. It is a historical fact that Mr. Spink was excluded from the plan during those years – that is, he did not in fact participate in the plan – and no one challenges the legal conclusion that such treatment was lawful when it occurred. By holding that OBRA '86 requires that credit be granted for that period, the decision below effectively makes unlawful today an exclusion that was lawful when it occurred, and therein lies the retroactivity. The decision below treats Mr. Spink the same as if OBRA '86 had been the law ever since ERISA was passed.

B. Congress Plainly Stated Its Intent That this Provision of OBRA '86 Apply Prospectively Only.

On this point, we subscribe to the discussion in the brief of Lockheed and we will not burden the Court with a duplicative demonstration of the obvious intent of Congress, plainly stated in the statute, that this change in ERISA apply prospectively only. How much more clearly could Congress state its intent than to say that the change applies "only with respect to plan years beginning on or after January 1, 1988, and only with respect to service performed on or after such date"? OBRA '86, section 9204(b), 100 Stat. 1980 (1986).

But we would like to continue our discussion of how benefits accrue in defined benefit pension plans, because an understanding of that process demonstrates the error of the rationale given in the decision below. The rationale

of the decision below is that, unless Mr. Spink is permitted retroactive benefit accrual back to his original date of hire, he will suffer a reduction in the rate of his benefit accrual, in violation of a different section of OBRA '86.

But the decision below fails to appreciate the nature and significance of OBRA's prohibition on reduction in the rate of benefit accrual. Having assured all employees of the right to participate in a pension plan regardless of old age, Congress realized that the right to participate would be worthless if a plan could cut off accrual of benefits after a certain age. (This phenomenon was well-known when the upper age limit under the Age Discrimination in Employment Act was 65 but became controversial after the 1978 amendments raised the age limit to 70.)

To give meaning to the new rule that older employees must be permitted to participate, Congress had to prohibit cessation of accrual of benefits by reason of age. It did so in section 9201 of OBRA '86. Furthermore, anticipating that an unscrupulous employer might avoid that prohibition by merely reducing the rate of accrual (rather than cutting it off entirely), Congress added that the same prohibition applied not only to "the cessation of an employee's benefit accrual" but also to "the reduction of the rate of an employee's benefit accrual" because of age. OBRA '86, section 9201, amending section 4 of the Age Discrimination in Employment Act, 29 U.S.C. § 623(i)(1).

A cessation or reduction in the rate of benefit accrual is easy to picture. If a pension plan promises a monthly pension of $50 multiplied by the number of years that the employee has participated in the plan, employees in that plan accrue pension benefits at a rate of $50 per year of participation. After OBRA '86, it would be unlawful for that plan to provide that no further benefits accrue after age 65. It would be equally unlawful for the plan to provide that the rate of accrual is reduced to $10 for years of participation occurring after age 65.

OBRA's prohibition on plan provisions reducing the rate of accrual by reason of age has no application to Mr. Spink. Under the Lockheed plan, the rate of accrual does not change merely because the participant reaches any age. Mr. Spink's rate of accrual was the same at all times and, furthermore, the same as all other participants in the plan, both under and over age 65. Since the plan does not provide any reduction in rate, and Mr. Spink did not suffer any reduction in rate, the OBRA '86 ban on plan provisions reducing the rate of accrual by reason of age clearly has no application to this case and certainly cannot be used to justify retroactive application of the rule that older employees be permitted to participate from and after 1988.

C. Retroactive Application of OBRA '86 Would Vastly Multiply the Financial Burdens on Plans Beyond What Congress Intended.

The effect of the decision below on pension plans is immediate and severe. Even *prospective* application of OBRA '86 creates a new financial burden on plans by requiring that employees hired after age 60 be permitted to participate prospectively (reversing the original rule of ERISA that such employees could be excluded because of the cost). Retroactivity would dramatically compound the burden: not only must pension plans accept the older employee as a participant and fund his pension over a short period of time, under the decision below the pension must be inflated by taking into account the prior period when the employee did not in fact participate.

For example, suppose that an employee was hired in 1983 at age 60 and was excluded from the pension plan. In 1988, OBRA '86 takes effect and he joins the plan. In two more years, he retires. Applying OBRA '86 prospectively, he has two years of participation. Applying OBRA '86 retroactively (in accordance with the decision below),

he has seven years of participation. That means he receives more than triple the benefit, and the financial burden on the plan is more than three times greater, than if OBRA '86 were applied prospectively.[14]

The absolute dollars associated with this multiplier effect are very substantial. Using the same example, the monthly pension of our sample employee at retirement would be $100 if OBRA '86 were applied prospectively (2 years of participation at an accrual rate of $50 per year) versus $350 if OBRA '86 were applied retroactively (7 years at $50). Using the rates promulgated by the Pension Benefit Guaranty Corporation for valuing annuities, the value of a $100 monthly pension was $9,225 in 1988 and of a $350 monthly pension was $32,287. The difference – $23,062 – would have been the increase in cost to the plan in 1988, for just this one employee, if OBRA '86 had been applied retroactively. Today, eight years after OBRA '86 took effect, the cost of retroactive application is $53,433 – considerably more than double that amount.

While we are not aware of data showing exactly how many employees would be affected by retroactive application of OBRA '86 nationwide, the order of magnitude certainly can be estimated. According to the U. S. Department of Labor, in 1988 there were 32,166,000 participants in private, single-employer, defined benefit pension plans.[15] Multiply that by 37 percent to estimate the number of participants in plans that took advantage of the original ERISA provision permitting exclusion of

[14] This is a modest example. The multiplier effect is even greater in the case of Mr. Spink himself, who had approximately 9 years of service before the OBRA '86 effective date and only a year and a half afterward, yielding a multiplication factor of more than seven.

[15] *Trends in Pensions 1992*, U. S. Department of Labor, Pension and Welfare Benefits Administration 603.

employees hired after age 60.[16] Multiply that by the ratio of affected individuals to total participants, using the Lockheed plan as an example, and the estimate would be over 32,000 individuals affected nationwide.

If the cost of retroactive application of OBRA '86 for a typical participant were $53,433 today, the total cost nationwide could therefore be as high as $1.7 billion today. Even if the actual cost were half the estimate, it could still be fairly characterized as very substantial – certainly substantial enough that Congress should not be found to have imposed it on the nation's pension plans absent a clear intent to do so, in accordance with *Landgraf v. USI Film Products*, 114 S. Ct. 1483 (1994).

As to the second question presented, therefore, the decision below not only commits error but does so in a way that dramatically multiplies the liability, resulting in a financial burden on plans far greater than Congress could ever have envisioned from the prospective application that it clearly set forth in OBRA '86. The decision below should be reversed.

CONCLUSION

In ERISA, Congress sought and achieved a balance between the rights of employees and the burdens on employers, recognizing that misguided regulation could easily go overboard and, ironically, lead to the reduction or elimination of employee benefit plans. *Ingersoll-Rand v. McClendon*, 498 U.S. 133 (1990). This Court has repeatedly upheld the balance that Congress achieved in ERISA

[16] This percentage is derived from a published survey of the largest salaried pension plans of 50 of the largest manufacturing companies in the United States in 1988. *Top 50 – A Survey of Retirement, Thrift, And Profit Sharing Plans Covering Salaried Employees of 50 Large U. S. Industrial Companies as of January 1, 1988*, The Wyatt Company (1988).

against those who would upset it by imposing additional burdens on employers and plans, and the time has come to do so again.

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